



AgEcon SEARCH
RESEARCH IN AGRICULTURAL & APPLIED ECONOMICS

The World's Largest Open Access Agricultural & Applied Economics Digital Library

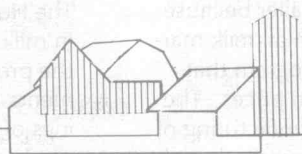
This document is discoverable and free to researchers across the globe due to the work of AgEcon Search.

Help ensure our sustainability.

Give to AgEcon Search

AgEcon Search
<http://ageconsearch.umn.edu>
aesearch@umn.edu

*Papers downloaded from **AgEcon Search** may be used for non-commercial purposes and personal study only. No other use, including posting to another Internet site, is permitted without permission from the copyright owner (not AgEcon Search), or as allowed under the provisions of Fair Use, U.S. Copyright Act, Title 17 U.S.C.*



Milk production rebounding to new high

U.S. milk production will likely rebound to a new high in 1985. This would follow a downturn in 1984 that was engineered by a 15-month milk diversion program that paid cooperating dairy farmers to reduce their production. The rebound is pushing milk production well in excess of commercial disappearance, resulting in large federal government outlays to maintain the price supports offered by current dairy legislation. These developments are occurring while Congress is debating new multi-year farm program legislation that among other things will try to rein in the excess capacity of the U.S. dairy sector.

USDA monthly releases show that milk production this year is steadily outpacing both last year and the record performance 1983. In August of this year, milk production was up 9.7 percent from a year earlier and up 5.3 percent from the record for that month set in 1983. The August figures boosted year-to-date production to more than 3.5 percent above the same period in 1984 and to nearly 1 percent above the outturn in the first eight months of 1983. If the gains recorded in August extend through the final four months of this year, milk production for all of 1985 would approach 143 billion pounds, up from 135.4 last year and the record 139.7 billion pounds of 1983.

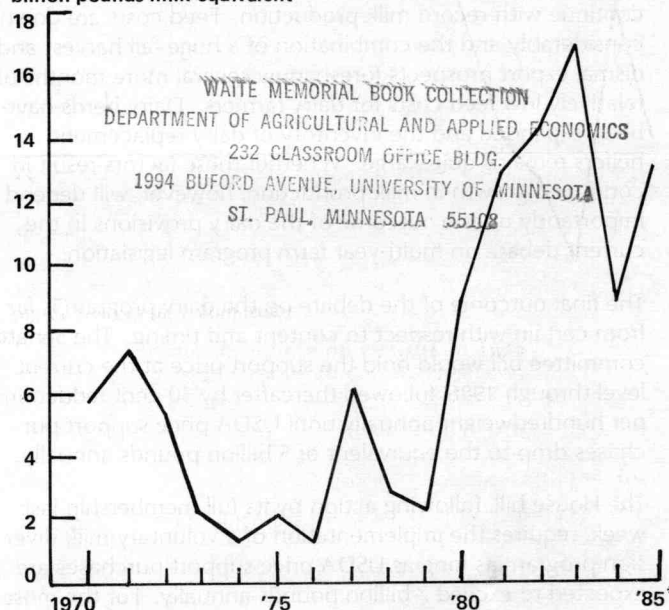
Milk production in the five states of the Seventh Federal Reserve District is also on a record-setting pace. In August, the five-state total was up nearly 12 percent from the year before and up more than 8 percent from two years earlier. Gains were evident in all District states and were most pronounced in Wisconsin.

With the upturn in production, the oversupply of milk has become much more pronounced. Commercial disappearance of milk recorded an unusually strong rise of 3.2 percent in 1984. But this year, the uptrend has slowed. The latest USDA projection foreshadows a 1.3 percent rise for all of 1985. With growth in production outstripping that for commercial disappearance, USDA purchases of manufactured dairy products—purchases that are undertaken to maintain minimum price supports—are rebounding sharply. It is now estimated that such purchases in 1985 will remove the equivalent of 13 billion pounds of milk from commercial market channels. Such a level would sharply exceed the 8.6 billion pounds of removals in 1984 but still fall short of the 16.8 billion record in 1983. The 1985 purchases will likely represent about 10 percent of all milk marketed by dairy farmers and cost taxpayers more than \$2 billion.

An expanding herd of dairy cows and more output per cow underlie this year's rebound in milk production. By August, the nation's inventory of dairy cows was up 2.7 percent from a year ago and comparable to the level of two years ago. Si-

USDA price support purchases of dairy products up sharply in 1985

billion pounds milk equivalent



*USDA estimate.

multaneously, milk per cow exceeded the declining year-earlier level by 6.8 percent and the August 1983 outturn by 5.6 percent.

The larger dairy herd and the increased output per cow reflect the more favorable returns to dairy farmers that result from lower feed costs. Reflecting this, the price of a common dairy protein feed concentrate so far this year has averaged 13 percent less than a year ago and 6 percent less than two years ago. Concentrates account for about 45 percent of the variable cash expenses associated with producing milk, while all feed costs account for about 60 percent. Consequently, declines in feed costs can substantially improve the profitability of producing milk. The declines in feed costs this year have been partially offset by lower milk prices. Nevertheless, the milk-feed price ratio has risen to levels historically conducive to expanding milk production. Since the end of March, the milk-feed price ratio has averaged 10 percent higher than last year and 2 percent higher than in 1983.

Milk prices received by farmers have declined this year in response to lower support prices and the over-supply of milk. Since March, prices of all milk marketed by farmers have averaged 6 percent lower than in the same months the year before. The declines have been widening, with September prices—at \$12.20 per hundredweight—down 10 percent from a year earlier. The effective declines experienced by dairy

farmers, however, have been considerably smaller because the 50-cent-per-hundredweight assessment on all milk marketings during the 15-month milk diversion program that ended in March are not netted out of year-ago prices. The support price of milk typically used in the manufacturing of dairy products currently stands at \$11.60 per hundredweight, following a 50-cent reduction on April 1 and another 50-cent reduction on July 1. Special legislation enacted October 1 extends the current support price through mid-November. At that time, new legislation governing the dairy program will hopefully be in place.

In looking ahead, it appears that dairy farmers are poised to continue with record milk production. Feed costs are down considerably and the combination of a huge fall harvest and dismal export prospects foreshadow several more months of relatively low feed costs for dairy farmers. Dairy herds have been expanded and the inventory of dairy replacement heifers remains quite large. Whether these factors result in continued growth in milk production, however, will depend importantly on the outcome of the dairy provisions in the current debate on multi-year farm program legislation.

The final outcome of the debate on the dairy program is far from certain with respect to content and timing. The Senate committee bill would hold the support price at the current level through 1986, followed thereafter by 50-cent reductions per hundredweight annually until USDA price support purchases drop to the equivalent of 5 billion pounds annually.

The House bill, following action by its full membership last week, requires the implementation of a voluntary milk diversion program as long as USDA price support purchases are expected to exceed 7 billion pounds annually. For the most part, the program would be similar to the one that ended in March, with producer assessments capped at 50 cents per hundredweight on all milk marketings and payments to producers who volunteer to cut their production by 5 to 30 percent at \$10 for each 100 pounds of reduced marketings. In addition, the House bill would incorporate a whole-farm buyout option. With respect to support prices, the House bill would tie future levels to a cost of production formula. According to some analysts, the formula currently in the House bill could raise the support prices of milk by 15 cents next year and up to 30 cents annually thereafter.

The two bills offer significantly different approaches for dealing with the imbalance in milk production. Over time, the Senate committee bill would be more successful at bringing production into balance with commercial disappearance, assuming technological developments in the interim don't materially reduce the break-even cost for dairy farmers. Lowering the support price tends to address the imbalance by encouraging a cutback in production and simultaneously—through lower retail prices—by encouraging faster growth in consumption. But the Senate committee bill delays any reduction in the support price until January of 1987. With the expansion now underway among dairy farmers, such a delay would likely aggravate the imbalance in milk supplies in the near term and result in still larger government price support outlays in 1986.

The House bill offers more hope for addressing the imbalance in milk production in the near term, but it could aggravate the problem over the longer term. The combination of payments to participating farmers and assessments on marketings of all dairy farmers would probably result in lower milk production next year. In addition, the House bill has an added appeal in that the producer assessments would generate a pool of funds that could partly offset the U.S. Treasury's exposure to the producer payments and the price support purchases. But over the longer haul, the House bill could further institutionatize the chronic excess in milk production. Compared to a program of lowering the support price, a milk diversion program with payments to participating farmers tends to keep more dairy farmers in business for a longer period of time, albeit at a smaller scale of production. As such, it is doubtful that a new diversion program with a whole-farm buyout option can achieve permanent production cuts as quickly as a support price reduction program. A lack of permanent production cuts was one of the most significant shortcomings of the 15-month diversion program that ended in March. Moreover, the provision in the House bill that ties future support prices to production costs raises the probability of higher support prices in the years ahead. With producer assessments capped, rising support prices could offset the assessments in a couple of years and encourage dairy farmers to add to the oversupply of milk. These possibilities should be weighed with care as compromises on dairy legislation are formed in the weeks ahead.

Gary L. Benjamin

Cutback in hog production may end soon

The downtrend in hog production that began in early 1984 has continued through the summer months according to the USDA's most recent *Hogs and Pigs* report. Although somewhat smaller than earlier indicators had suggested, the cut in production will drop hog slaughter and pork supplies below year-ago levels through early 1986. However, operators' intentions foreshadow a stabilizing or possible expansion of production that could increase slaughter rates during the second and third quarters of next year. These intentions probably reflect expectations for improvement in operating margins in the coming months.

Faced with low prices and negative operating margins through much of the year, hog farmers have been under pressure to curtail production. However, record litter sizes over the last several quarters and large imports of hogs blunted the effects of reduced breeding herds and lower farrowings on pork supplies. As a result, market hog inventories through the first half of 1985 held near the year-ago level. The most recent report from USDA, however, shows the cumulative effect of breeding herd cuts and reduced farrowings in lowering the September 1 market hog inventory in the ten principal states by more than 3 percent from a year ago. The September inventory of hogs kept for breeding purposes recorded a second consecutive year-to-year decline. Breeding inventories were down 3 percent from last year and at the lowest September level since 1975.

The number of sows that farrowed during the June-August period, although down from the level of a year ago, was somewhat larger than expected. At about 2.2 million, the number of sows farrowing on farms in the ten major producing states was down 3 percent from the same period a year ago. The June survey of producers' intentions pointed to a year-to-year decline in farrowings of almost 5 percent during the summer months.

Again this summer, the drop in farrowings was partially offset by an increase in the average litter size. During the June-August period the number of pigs per litter averaged 7.73, almost 2 percent above the previous record for the quarter, established last year. This marked the fifth consecutive quarter of record litter sizes reported by producers in the ten quarterly survey states. Because of the record number of pigs per litter, this summer's pig crop was down only 1.3 percent from the level reported last year.

Producers' intentions point to further, but smaller, declines in the number of sows farrowing during the fall and winter quarters. During the September-November period, producers in the ten major states intend to have about 2 percent fewer sows farrowing than during the same months last year, a somewhat smaller drop than the 3.5 percent year-to-year decline suggested in their June intentions. Intentions for the December-February period point to only a slight drop in the number of sows farrowing compared to last winter.

Hog slaughter this summer exceeded year-earlier levels for the second consecutive quarter. After holding about 1 percent above a year ago during the spring, preliminary data on federally inspected hog slaughter suggest a 5 percent year-to-year gain for the third quarter. Much of the gain occurred in July when a 10 percent year-to-year gain in slaughter triggered a three-month downtrend in hog prices. Hog slaughter continued above the year-ago rate during August, but by only 2.5 percent, before receding to a 1.3 percent gain during September. Over the same three-month period, pork production followed a similar trend.

The September readings of market hog inventories and pig crops suggest that hog slaughter and pork production will dip below year-ago levels during the fall and winter quarters. Although both the March-May pig crop and September inventory estimates indicate declines in fourth quarter hog slaughter, they are inconsistent regarding the extent of the drop. The spring pig crop that was reported in June showed a 3.5 percent decline from a year ago. Given the historical relationship between the pig crop and fourth quarter slaughter, it pointed toward a drop of about 3 percent in hog slaughter this fall. However, the September inventory of market hogs weighing between 60 and 179 pounds, which accounts for most of the hogs slaughtered in the fourth quarter, was down 5 percent from last year. Moreover, a typical slaughter-to-inventory ratio suggests a drop in hog slaughter of about 6.5 percent during the final three months of the year. The USDA estimate of fourth quarter pork output is more consistent with the pig crop estimate of slaughter, pointing to a 3.3 percent year-to-year drop in pork output.

The inventory of market hogs weighing less than 60 pounds, down about 2 percent from last September, along with a 1.3

percent drop in this summer's pig crop suggest that hog slaughter may continue to show year-to-year declines during the first three months of 1986. However, the drop is likely to be very small. If the slaughter-to-pig crop ratio conforms to historical norms, first quarter hog slaughter could be about 1 percent lower than a year earlier.

Preliminary indications of hog slaughter and pork production during the second and third quarters of next year portend an end to the downturn in hog production. Producers in the ten leading states reported intentions to cut farrowings by about 2 percent for the September-November period. However, the intentions stated in the last several surveys have tended to overstate the actual cuts in farrowings. If this trend continues, second quarter hog slaughter could hold near a year ago. Moreover, the initial intentions of producers in the ten-state group for the December-February period point to virtually no change in sow farrowings from the previous year's level. While these intentions will be influenced by market conditions over the next several months, it appears that producers are poised to expand production next year.

Hog prices during the third quarter have trended down and remained well below year-ago levels. Third quarter barrow and gilt prices at the seven major markets averaged about \$43.83 per hundredweight, well below the \$51.21 per hundredweight average for the comparable period last year. Moreover, the downtrend evident through most of the quarter pushed hog prices below \$40 per hundredweight in early September before rising slightly later in the month.

Although hog prices typically decline seasonally during the fourth quarter, declines in hog slaughter and lower total meat supplies could lend some strength to prices. While a 3 percent rise in poultry production will partially offset year-to-year declines in beef and pork production of about 5 and 3 percent, respectively, total meat output is expected to drop 2.4 percent from last year. As a result, hog prices are expected to range mostly in the low-to mid-\$40s per hundred weight during the final three months of 1985, well below the \$47.65 average of the previous year. However, continued declines in beef and pork production next year are expected to boost hog prices to the upper \$40s during the first quarter, near the year-earlier average of \$47.32 per hundredweight.

Peter J. Heffernan

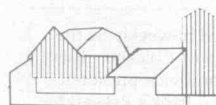
AGRICULTURAL LETTER (ISSN 0002-1512) is published bi-weekly by the Research Department of the Federal Reserve Bank of Chicago. It is prepared by Gary L. Benjamin, economic adviser and vice-president, Peter J. Heffernan, economist, and members of the Bank's Research Department, and is distributed free of charge by the Bank's Public Information Center. The information used in the preparation of this publication is obtained from sources considered reliable, but its use does not constitute an endorsement of its accuracy or intent by the Federal Reserve Bank of Chicago.

To subscribe, please write or telephone:
Public Information Center
Federal Reserve Bank of Chicago
P.O. Box 834
Chicago, IL 60690
Tel.no. (312) 322-5111

Selected Agricultural Economic Indicators

			Percent change from		
	Latest period	Value	Prior period	Year ago	Two years ago
Prices received by farmers (1977=100)					
Crops (1977=100)	September	120	-0.8	-13	-12
Corn (\$per bu.)	September	112	-1.8	-17	-17
Oats (\$per bu.)	September	2.31	-5.3	-20	-30
Soybeans (\$per bu.)	September	1.12	-2.6	-33	-28
Wheat (\$per bu.)	September	4.97	-2.4	-18	-40
	September	2.90	0.3	-16	-21
Livestock and products (1977=100)					
Barrows and gilts (\$per cwt.)	September	127	-0.8	-10	-7
Steers and heifers (\$per cwt.)	September	39.60	-8.5	-16	-12
Milk (\$per cwt.)	September	50.60	-2.5	-16	-10
Eggs (¢per doz.)	September	12.20	0.8	-10	-10
	September	62.2	7.6	7	-5
Prices paid by farmers (1977=100)					
Production items	September	162	-0.6	-1	1
Feed	September	147	-2.0	-5	-5
Feeder livestock	September	111	-0.9	-14	-22
Fuels and energy	September	137	-7.4	-8	-7
	September	203	0	2	-2
Producer Prices (1967=100)					
Agricultural machinery and equipment	August	294	-0.4	1	3
Fertilizer materials	August	338	-0.2	0	3
Agricultural chemicals	August	228	-0.8	-2	3
	August	458	0.4	2	0
Consumer prices (1967=100)					
Food	August	324	0.2	3	8
	August	310	0.1	2	6
Production or stocks					
Corn stocks (mil. bu.)	June 1	2,832	N.A.	32	-43
Soybean stocks (mil. bu.)	June 1	609	N.A.	29	-23
Beef production (bil. lbs.)	August	2.12	3.1	1	0
Pork production (bil. lbs.)	August	1.21	5.6	3	-3
Milk production (bil. lbs.)	August	12.3	-0.9	10	5

N.A. Not applicable



AGRICULTURAL LETTER

FEDERAL RESERVE BANK OF CHICAGO

Public Information Center

P.O. Box 834

Chicago, Illinois 60690

(312) 322-5112

PRESORTED
FIRST CLASS



AB
LOUISE LETNES, LIBRARIAN
DEPT. OF AGRIC. & APPLIED ECON.
221 CLASSROOM OFFICE BUILDING
1601 BUFORD AVENUE
ST. PAUL, MN 55106